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SUBJECT: SENATOR LUGAR DISCUSSES ENERGY SECURITY WITH EU  
OFFICIALS

¶1. (SBU) Summary. Senator Lugar met separately this week with EU Competition Commissioner Nellie Kroes and EU Energy Commissioner Andris Piebalgs. The meeting with Commissioner Kroes focused on the EU's efforts to liberalize the internal market for natural gas and electricity. Kroes provided the Senator with an overview of her efforts to bring competition to the European energy market and stressed the need to move away from national vertically integrated firms and towards a true common European market for energy. The meeting with Commissioner Piebalgs focused on the external energy market, and the challenge of bringing energy security to Europe. While acknowledging the importance of seeking alternate supplies for gas, Piebalgs downplayed the threat posed by Russia's dominance of gas supply to Central Europe. Uncharacteristically, he seemed to backpedal on meeting European climate goals by suggesting that Central Europeans could gain energy security by building new coal-fired power plants to be offset by trading in Clean Development Mechanism (CDMs). End Summary.

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Discussions with Commissioner Kroes  
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¶2. (SBU) The meeting with Commissioner Kroes focused on the EU's efforts to liberalize the internal market for natural gas and electricity. Kroes provided the Senator with an overview of her efforts to bring competition to the European energy market and stressed the need to move away from national vertically integrated firms and towards a true common European market for energy. She said that she is convinced of the need to unbundle energy supply and energy transmission as a way to enhance competition in the energy market. Kroes sees globalization as her biggest challenge at the moment, but believes globalization is a good thing. She stressed the need to look forward and not pull back because of the financial crisis. She praised U.S. policy on globalization and said that the EU is learning from the U.S. model.

¶3. (SBU) Regarding the EU's attempt to build a common market for gas and electricity, Kroes said the biggest challenge is protectionism in member states. She said the EU needs to communicate the benefits of a common market to the people of the EU to overcome member states' tendencies to protect national champions. On the Third Country, or so called "Gazprom" clause, Kroes said this is something the EU had to tackle and that the Commission couldn't be naive and believe that the Russians wouldn't try to take advantage of the situation and snap-up unbundled transmission networks. She said unbundling is not something that can be applied only to EU companies, it has to apply to all companies doing business in the EU. She views Gazprom as tough, very confident, and also very political.

14. (SBU) On the Nabucco pipeline project, Kroes said that unless the EU can reach a transit agreement with Turkey, there will be no Nabucco. She appealed for U.S. support with Turkey to encourage them to look beyond their own domestic needs for natural gas. Kroes believes the situation in Georgia may spur some in the EU to push harder for Nabucco and other options for diversifying gas supply. Nonetheless, Kroes was not confident about finding a solution to enable Nabucco, stating "time is not on our side."

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Discussions with Commissioner Piebalgs  
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15. (SBU) The meeting with Commissioner Piebalgs focused on the external energy market, and the challenge of bringing energy security to Europe. Piebalgs stressed the importance of the unbundling provisions in the Commission's proposed Third Energy Package. He explained that one of the things that makes Europe vulnerable to supply disruptions is the fact that the gas and electricity grids in member states are not interconnected. According to Piebalgs, vertically integrated energy companies have no incentive to invest in building cross-border interconnections when doing so would erode their ability to set prices within their captive markets. He cited the example of the lack of interconnection between Spain and France, a subject of fruitless negotiations for the past 20 years. Piebalgs believes that unbundling the transmission networks will spur the construction of cross-border interconnections bringing more completion to the market, increasing Europe's energy security, and ultimately resulting in lower prices for consumers.

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16. (SBU) While acknowledging the importance of seeking alternate supplies for gas, Piebalgs downplayed the threat posed by Russia's dominance of gas supply to Central Europe. Piebalgs said the EU is continuing to look for alternative gas supplies from a variety of sources including the Caspian Sea region, Iraq, Nigeria (via the proposed Trans-Saharan pipeline), and increased supplies from Norway. Piebalgs argued that the European market is currently well supplied with gas and there is no immediate need to seek new gas supplies, adding that he is receiving no industry pressure asking for new supplies. He stated he was confident in Gazprom's ability to supply European needs going forward. In fact, Piebalgs stated he is confident that the EU will be able to reduce its gas needs going forward through improvements in energy efficiency, conservation measures, and increasing the use of renewable energy. He also views nuclear as a part of the mix for those member states who favor it. Even if Russian gas production does decline, Piebalgs believes that Russia would cut back supplies to its own people before they would cut off gas supplies to paying customers in the West. Uncharacteristically, Piebalgs seemed to backpedal on meeting European climate goals by suggesting that Central Europeans could gain energy security by building new coal-fired power plants to be offset by trading in Clean Development Mechanism (CDMs).

17. (SBU) On Nabucco, Piebalgs sees two major difficulties: transit through Turkey and securing sufficient gas supplies. He views Turkey as the biggest obstacle, with Turkey uncertain whether to demand all the gas for its own use, purchase all the gas and then resell it to Europe, or operate merely as a transit state. Turkey is worried that the Azeris will apply higher prices to all the gas entering the pipeline, regardless of its destination. Piebalgs said that Turkey needs to understand that there are alternatives, such as White Stream, available for transit. On gas supply for Nabucco, Piebalgs sees the first challenge as convincing Azerbaijan to go ahead with development of its gas reserves. The second challenge is to find a way to reach an accommodation between Azerbaijan and Turkmenistan so that gas from Turkmenistan can flow west.

18. (SBU) One of the challenges Piebalgs sees going forward is that more and more of the world's oil and gas supply is becoming nationalized. He is unsure whether the EU can continue to rely on commercial actors to work the market to obtain sufficient energy supplies or if there will come a time when the EU will have to start looking at inter-governmental negotiations for energy supplies. Citing Russia, he asked "can we expect the market to change Russia?" Piebalgs is not willing to give up on the market economy, but realizes there will be a lot of pressure by Russia against any competition. Piebalgs indicated that he believes oil and oil prices are bigger problems for the EU's energy security than is natural gas. Even with increased use of renewables for transit, the transit sector will remain dependent on oil supplies. Gas can be substituted.

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Tri-Mission Dinner  
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19. (SBU) At a Tri-Mission dinner attended by representatives from the EU, NATO, and Government of Belgium, Senator Lugar stressed the importance of energy security and encouraged the EU to develop its energy policy. External Affairs Commissioner Benita Ferrero-Waldner agreed on the importance of energy security and stressed the need to bring the Nabucco pipeline project forward. Robert Cooper, Council Director General for External Affairs, also noted the importance of Nabucco but added that the EU should also focus on other efforts to diversify supply and other opportunities to enhance energy security through changes in EU energy policy. The EU's Nabucco Coordinator, Jozias Van Aartsen, agreed on the need to liberalize the European energy market. On Georgia, Van Aartsen indicated that the EU could consider inviting Georgia into the Energy Community as a first step in the road towards EU membership. Van Aartsen added that post-Georgia private companies are more skeptical about investing in Russia.

110. (SBU) Comment. In general EU officials were receptive and supportive of U.S. initiatives to improve the EU's energy security. Commissioner Piebalgs statements downplaying Europe's needs for natural gas and touting the reliability of Russia as a supplier were unexpected and out of character with previous statements from him. The comment about using

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CDM's to let member states buy their way out of any gas supply shortfalls is especially troubling. End Comment.

Silverberg

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